Pension flexibility: too taxing for many

Recent HMRC statistics highlight the over-taxation of some pension benefits.

More than one million people have received flexible pension payments thanks to therules introduced just over four years ago. HMRC's most recent statistics, to the end of March 2019, show that 1,113,000 people have withdrawn over £25,600m from their pensions, across 6,136,000 payments. The amounts withdrawn and the number of payments have both increased each tax year – in 2018/19 there were over 2,400,000 payments totalling £8,180m.

However, the system is causing some problems for HMRC. In the first quarter of 2019 HMRC refunded £31.1m of overpaid tax to over 12,500 people who had used pension flexibility. The over-collection is a result of HMRC's insistence on using emergency tax codes where a pension provider does not have a current tax code for the individual, which is usually the case on a first withdrawal. More often than not, emergency tax codes create too high a tax deduction, as the example shows.

Emergency, Emergency!

Graham, who lives in England, expects to have an income of about £28,000 in 2019/20. He decided to draw £24,000 from his pension plan as an uncrystallised funds pension lump sum (UFPLS). He knew that a quarter of this would be tax free, with the £18,000 balance taxable. As that would still leave him comfortably below the £50,000 higher rate threshold, he expected to receive £20,400 as a net lump sum (£24,000 - £18,000 @20%).

In fact, he received £17,619 because an emergency tax code was applied to the taxable element of his UFPLS.

The excess tax can be reclaimed and HMRC has created dedicated forms to speed up the repayment process. In theory if no reclaim is made, the tax should eventually be refunded once HMRC undertakes its end of year reconciliation – but that could mean waiting over 12 months if the payment is taken early in the tax year.

If you are thinking about using pension flexibility, it pays to take advice before asking for the payment. In some circumstances the emergency code issue can be sidestepped, but if it cannot, then you need to be aware of what you will receive initially and the process of tax reclaim.

Brave new world of UBI?

If those three letters mean nothing to you now, they may do soon.

Universal Basic Income (UBI) has become a topic attracting attention among some think-tanks and political parties, both in the UK and overseas. The idea behind UBI is simple and has an obvious electoral appeal.

In its most basic form, UBI would give every citizen a government paid regular cash income, subject to the most minimal of qualifications, eg 18 or over and not imprisoned. Millionaires and paupers, students, full time employees and pensioners would all receive the same amount. In theory, UBI offers the opportunity to revise radically – or even abandon completely– the existing support systems of means-tested social security benefits and tax credits. In practice many UBI proposals recognise that that there would probably need to be some additional benefits for people with disabilities.

Unsurprisingly, the question of whether UBI is affordable is a contentious one. The corollary is whether what is affordable could be classed as a meaningful UBI. A good example of the affordability question emerged in a structure recently put forward by the New Economic Foundation (NEF). This think tank suggested for the UK excluding Scotland:

- Scrapping the income tax personal allowance;
- Replacing it with a UBI of £48 a week for everyone aged 18 or over with a National Insurance Number and income of up to £100,000 a year;
- Adjusting means-testing to allow for UBI; and
- Restoring the real value of Child Benefit to its 2010/11 value, before benefit freezes started to erode its purchasing power.

The NEF calculates that such reform would generate a net *saving* of £2.9bn for the Exchequer. If that seems surprising, it is because of the subtle impact of replacing the personal allowance (worth £2,500 a year to a basic rate taxpayer) with a UBI of about the same amount. The reform would mean that the higher rate tax threshold dropping to £37,500 (from the current £50,000), leaving most people with income above that level worse off. As the NEF said, the effect is their proposals would be “highly redistributive”.

John McDonnell, the Shadow Chancellor, has said that he would trial UBI if Labour were elected. It is not inconceivable that a future Conservative chancellor might ‘borrow’ some UBI ideas, given the long running problems surrounding Universal Credit. Pre-election tax planning may have already begun.

Another take on long-term care costs

A new set of proposals for funding long-term care has emerged from a significant source.

The funding of long-term care is an issue that beats even Brexit in terms of protracted political procrastination. A Royal Commission on the subject was established in 1997 and reported in 1999. Its proposals were rejected by the then Labour government as too costly.

Since then there has been a steady flow of reports, reviews and even another Commission report (although not royal this time around). Over the last 20 years the system become fragmented, with Scotland providing free personal and nursing care which the rest of the UK does not. The last attempt to introduce a new system in England did manage to reach the statute book, but its start date was deferred. The scheme was then abandoned entirely, shortly after the 2017 general election.

That election featured a rapidly withdrawn proposal from the Prime Minister – dubbed a 'dementia tax' by opposition parties – that would have allowed everyone to retain £100,000 of assets, regardless of their total care costs. After the election a green paper on care funding was promised, but it too has suffered frequent deferrals and, after several missed deadlines, is now only due to be published "at the earliest opportunity".

Total spend by type of care	
Care type	**Average weekly cost**
Domiciliary	£252
Residential	£617
Nursing	£856

Source: Fixing the Care Crisis CPS April 2019

Into this limbo land another paper has now emerged. This one came from a think tank, the Centre for Policy Studies, which is closely linked to the Conservative Party. The paper's author, Damian Green, is a former Secretary of State for Work and Pensions and Chair of the All Party Parliamentary Group on Longevity. His ideas include scrapping the current means test and, in its place, providing a Universal Care Entitlement (UCE) paid by the state, which individuals could top up from their own resources and private insurance.

The main way of funding would be by an extra 1% on National Insurance Contributions for those aged over 50. However, some experts have questioned whether this would produce enough revenue, given the existing funding shortfalls.

For the foreseeable future – although surely not another 20 years – the key remains to continue making sure your retirement provisions are sufficient to cover the quality of care you require.

Dividends wobble with 40% cuts

Recent dividend announcements have been an unwelcome reminder for some investors that peaks also have downsides.

Dividends matter to investors in UK shares. The UK stock market has historically been one of the higher yielding of the world's major share markets. For example, on 24 May the average dividend yield in the UK, based on the FTSE All-Share Index, was 4.26% against just 1.94% across the Atlantic, as measured by the S&P 500 Index.

The high level of dividends has made UK equity income funds a popular sector, a factor helped by over ten years of sub-1% base rates. As many investors, both individual and institutional, rely on dividend income, UK listed companies are extremely reluctant to cut their dividend payments, even when declining profits suggest they should do so.

While the UK market as a whole has a high dividend yield in terms of payments made, a handful of companies dominate. The latest survey from Link Asset Management (LAM) showed that in the first quarter of 2019 just over half of the total £19.7bn dividends paid out originated from only five companies. Number five in the top payers table was Vodafone, the telecoms company.

In May Vodafone announced that it would be making a 40% cut in its dividend. It was followed later in the month by Royal Mail also revealing a cut in its dividend of 40%. On the same day as Royal Mail wielded the dividend axe, Marks and Spencer confirmed the 40% reduction in its dividend it had revealed earlier this year. All three companies have had a strong following amongst private investors thanks to their (previous) high dividend yield and household name recognition. The trio have also each had their own structural problems, but they are not alone. For instance, many experts think Centrica, the owner of British Gas, will soon be forced to cut its generous dividend.

The lesson from May's dividend cuts and LAM's dividend concentration figures is that dividend data are not always what they seem. If you are looking for an income investment from UK (or overseas) shares, you need to understand the facts behind the numbers. Please get in touch if you may be affected by dividend reductions.

How well do you understand inheritance tax?

A survey by HMRC published in May concluded that the public have a relatively poor knowledge of inheritance tax (IHT) rules and lack of confidence in what they do know.

HMRC recently commissioned a survey of 947 people who had made gifts in the last two years. To assess knowledge of the IHT system among these donors, they were asked eight questions, which are shown below. Now it is your turn to try:

No	Statement	True or False?
1	A donation to a charity or a qualifying political party can count as a gift that is exempt from inheritance tax	
2	Inheritance tax may be paid on gifts totalling more than £325,000 if the person who makes the gifts dies within seven years of making them.	
3	A person can give as many gifts of £250 as they want in a year and not be subject to inheritance tax, as long as each gift is to a different person	
4	Inheritance tax may be charged at 40% on gifts to individuals given by the deceased in the three years before their death	
5	A gift can be the difference between the value of property and the actual price that the buyer pays	
6	Inheritance tax will always be payable on gifts over £3,000 given in the seven years before death	
7	A gift up to £1,500 to a niece or nephew getting married is always tax free	
8	A married couple or civil partners can leave up to £950,000 to their children without paying inheritance tax	

58% answered five or more questions correctly, while just 37% gave themselves a confidence rating of over 6 out of 10 on answering the questions. After adjusting for confidence levels,the survey concluded that the proportion with a “high knowledge” – as opposed to simply lucky with their answers – was just one in four.

The correct answers are shown below. Whatever your score, it is worth considering why HMRC should have undertaken such a survey at this time. It may be no coincidence that the Office of Tax Simplification is due to publish its second report on IHT simplification soon. Rationalising the rules on lifetime gifts is an obvious target, but as ever with simplification, there would be some losers. We can help you consider where you might stand on the wining and losing scale.

Answers: True: 1, 2, 3, 4, 5, 8 False: 6, 7